FTX Australia Pty Ltd
Level 6, 228 Pitt Street
Sydney NSW 2000

29 May 2022

Director – Crypto Policy Unit
Financial System Division
The Treasury
Langton Crescent
Parkes ACT 2600

via email: crypto@treasury.gov.au

Response to crypto-asset secondary service providers: licensing and custody requirements consultation

Dear Treasury,

Thank you for the opportunity to be able to provide comments on the consultation paper – *Crypto-asset secondary service providers: Licensing and custody requirements*. This paper is an important step in implementing the bipartisan recommendations of the Select Committee on Australia as a Technology and Financial Centre. By ensuring that Australia has the right policy settings, we can ensure that consumers are provided with important protections while also ensuring that the policy framework is encouraging to innovators – retaining local talent and attracting skilled workers to Australia. We welcome the opportunity to provide input into this valuable process and look forward to engaging further with Treasury.

1. Introduction

FTX Australia Pty Ltd (**FTX Australia**) is a wholly-owned subsidiary of FTX Trading Limited. It holds an Australian Financial Services License (**AFSL**) regulated by the Australian Securities and Investments Commission (**ASIC**) to issue crypto-asset derivatives, futures and contracts for difference. It also provides Digital Currency Exchange services through an Australian Transaction Reports and Analysis Centre (**AUSTRAC**) registered entity. FTX Australia is part of the FTX Group (**FTX**).

FTX is one of the largest crypto-asset businesses in the world, allowing retail and institutional users to buy, sell, hold and trade spot and derivative crypto-asset products. FTX was established with the goal of becoming a global leader in crypto-asset services, not merely in terms of volume of assets traded on the platform, but more importantly in terms of technology, user experience, customer service and regulatory compliance.

In the three years since commencing operations, the FTX has obtained, or is in the process of obtaining, regulatory licences in major jurisdictions including the United States, EU, Dubai, Australia and Japan. With offices across the world it has established itself as one of the top crypto-asset trading firms in the world.

A key component of FTX's future global expansion strategy is obtaining the requisite licences and regulatory standing to operate in all of the world's major financial centres and beyond. We believe that despite having obtained licences around the world for both spot and derivative exchange services, that many jurisdictions still lack a solid approach and regulatory framework for crypto-asset activities, including crypto-asset derivatives.

The regulatory approach with regards to crypto-asset service providers varies significantly between jurisdictions. However, these approaches can be broadly grouped as the following:

1. Do nothing;
2. Prohibit crypto-asset activities;
3. Regulate these activities through traditional financial services legislation; or
4. Introduce bespoke regulation.

We note that this consultation process has arisen from a desire within the sector for greater regulation. FTX believes that an appropriately designed regulatory regime is in the best interests of both consumers and industry. By providing regulatory certainty, consumers can be confident that they are dealing with legitimate businesses and that their consumer rights can be enforced. Likewise, a clear regulatory regime will provide greater business certainty.

It is our view that the fourth approach, a bespoke regulatory framework, allows jurisdictions to best address the regulatory challenges posed by the unique nature of crypto-assets. But any bespoke regulatory framework must be, well thought out, balanced and appropriate. Any such regime must ensure that there is a balance between ensuring that consumers are provided with appropriate protections while also ensuring that innovation is not stifled.

The Select Committee on Australia as a Technology and Financial Centre (the **Senate Committee**) was an important bipartisan effort to position Australia at the forefront of global regulation to ensure that Australia is not left behind as this important sector continues to develop globally.

A significant amount of work has been undertaken by Treasury under the previous Government and we would urge the incoming Government to ensure that this remains a high priority. Since the Senate Committee, other like-minded jurisdictions have advanced their efforts to regulate crypto-assets including the United States and the United Kingdom. There is an opportunity to ensure that Australia can be a global leader in the regulation of digital assets and continue to attract strong talent.

We welcome the Treasury consultation paper and agree that a fit for purpose, technology neutral, and risk-based approach is required in order to develop a successful regime. We believe the purpose of regulation should not be to implement a "light touch" regime, rather it should ensure that regulation is appropriate and robust.

Our consultation response will centre around three areas of focus which FTX believes are of significant importance:

1. scope and regulatory perimeter;
2. definitions and regulatory requirements; and
3. digital asset custody.

We have selectively responded to consultation questions and have indicated which questions we have responded to in this document.

While we welcome the extensive work that has been undertaken to date on developing a licensing regime, we note that it is difficult for FTX to provide a more in-depth response (such as on costing), without a clear understanding of the nature of the crypto-assets that are in scope. We would strongly encourage a more fulsome consultation on the token mapping exercise in conjunction with the proposed licensing framework.

2. Scope and Regulatory Perimeter

As highlighted in the consultation paper, there are challenges as to which particular crypto-assets would be considered to be financial products under section 763A of the *Corporations Act 2001* (**Corporations Act**). In particular, the definition of what constitutes a Managed Investment Scheme is unclear and while some guidance has been issued in the form of Information Sheet 225 (INFO 225), there is ambiguity as to whether or not certain crypto-assets are considered a "financial product".

Although the underlying objectives of the Corporations Act are sensible, the regulatory requirements are not fully fit for purpose for the crypto-asset industry. It is acknowledged in the consultation itself that the Corporations Act and hence definition of a financial product was written prior to the invention and proliferation of crypto-assets, and as such this can result in significant friction to crypto-asset businesses that are uncertain of the regulatory perimeter. While some assets such as the crypto-asset derivatives offered by FTX are clearly financial products, it would not be appropriate for this classification to be applied to all crypto-assets.

Response Q1: Do you agree with the use of the term Crypto-Asset Secondary Service Provider (CASSPr) instead of 'digital currency exchange'?

We agree that the use of the term Crypto-Asset Secondary Service Provider (**CASSPr**) is a broader and more appropriate term than 'digital currency exchange' given that there are a number of service providers which are not necessarily exchanges. However we would suggest using an alternative term, as suggested in our response to question two.

Response Q2: Are there alternative terms which would better capture the functions and entities outlined above?

Although there are no fundamental issues adopting the term CASPPr, we suggest using more broadly used terms such as VASP (FATF) or CASP (EU).

Using an unfamiliar term could lead to a lack of alignment between Australian and international authorities. Furthermore, the term 'secondary' is not defined in CASSPr, which creates the question as to whether there are 'primary' service providers, and if so, what falls under the scope of a 'primary' service provider. In fact, the use of the word 'secondary' is contradictory with the proposed CASSPr scope which includes 'financial services related to an issuer's offer and/or sale of a crypto-asset', suggesting that issuers would be in scope of this regime.

We suggest the use of one of three of the following terms:

- Virtual Asset Service Provider (VASP)
- Crypto Asset Service Provider (CASP)
- Digital Asset Service Provider (DASP)

3. Definitions and regulatory requirements

The CASSPr definition mirrors that of the FATF definition in the *Updated Guidance for a Risk-Based Approach to Virtual Assets and Virtual Asset Service Providers*.[1] Utilising a definition which has been set by a global standard setting body is sensible and will ensure that it allows Australia to ensure that the FATF standards are adhered to in terms of scope. However, the exact scope of the definitions could vary depending on the interpretation. For example, the 'participation in and provision of financial services related to an issuer's offer and/or sale of a crypto-asset' should be well defined in the legislation or any supplementary guidance, as this could be interpreted broadly.

Additionally, although the consultation highlights that the regime would not apply to decentralised finance (**DeFi**) platforms or protocols themselves, a clear approach and proposed perimeter with regards to participants of a DeFi system should be considered in order to provide regulatory certainty.

The FATF elaborated on DeFi in the updated guidance and highlighted the need for governments to implement regulations to address 'persons with sufficient influence or control' over a DeFi application. These persons should be responsible for anti-money laundering (**AML**) and countering the terrorism financing (**CTF**) requirements. If there are 'persons with sufficient influence or control' over a DeFi application, these persons should be considered to be VASPs under the guidance, which would require compliance with the full suite of AML/CTF requirements, including the 'travel rule'. While we recognise that DeFi is not explicitly within the scope of this paper, the Government will need to take a balanced approach with regards to DeFi in order to be FATF compliant, while meeting the policy objective of not including DeFi activities in the CASSPr regime.

We agree that regulating DeFi activities under CASSPr is not appropriate and further policy work regarding DeFi is warranted. As such we would encourage further guidance on the scope of the regime. The regulatory perimeter for the emerging subsectors of the crypto industry such as DeFi and NFTs is often unclear and providing regulatory certainty to businesses could attract industry leaders to Australia.

The paper does not make it clear what regime applies where a digital services business offers services that are covered under both the Australian Financial Services (AFS) regime but also the proposed CASSPr regime. It is not in the interests of the industry to create a dual licensing regime and this should be avoided as much as practically possible. This could be achieved by providing a "fast track" application process for CASSPr's where they already hold an AFSL. For example, where an AFSL holder has already passed the "fit and proper" test, this obligation

[1] https://www.fatf-gafi.org/publications/fatfrecommendations/documents/guidance-rba-virtual-assets-2021.html

would be automatically met under the CASSPr framework. Therefore, only those requirements that are unique to the CASSPr regime would apply.

Guidance should be issued providing examples and criteria to assess which crypto-assets are financial products so that companies know what licence to apply for.

Australia has the opportunity to build an innovative framework. We believe that activities involving pure crypto products could be regulated through the new regime which would be tailored to crypto specific risks. This could very well include crypto products which could also arguably be considered to be financial products.

Response Q3: Is the above definition of crypto-asset precise and appropriate? If not, please provide alternative suggestions or amendments.

We agree that 'assets which are transferred, stored or traded electronically' should be considered to be crypto-assets, although we question whether the second part of the definition, 'whose ownership is either determined or otherwise substantially affected by a cryptographic proof', is required, rather it may be appropriate to consider amending the second part of definition to also be aligned to the FATF definition which ensures that these assets 'do not include digital representations of fiat currencies, securities and other financial assets that are already covered elsewhere'. This would ensure that digitally transferable assets are in scope unless they are already regulated elsewhere.

Response Q4: Do you agree with the proposal that one definition for crypto-assets be developed to apply across all Australian regulatory frameworks?

Yes, as this will ensure consistency across the entire jurisdiction. However, given the rapidly changing nature of crypto-assets, it is important to note that the regulator ASIC has raised concerns that crypto-assets could change in their characterisation depending upon certain features and as such a new regime, and the definitions under it, will need to be very careful not to inadvertently capture activities which do not need regulation beyond Australia's already very sound consumer protection laws and the general law by a definitional approach which captures future innovations unintentionally.

Response Q5: Should CASSPrs who provide services for all types of crypto-assets be included in the licensing regime, or should specific types of crypto-assets be carved out (e.g. NFTs)?

We do not believe that particular tokens should be carved out entirely, as NFTs could also represent financial products depending on what particular properties the NFTs have. However, NFTs used purely for artistic purposes or access to gaming should not be included in this regime. In essence, the regime should aim to be technologically neutral, and focus on the underlying substance of a crypto-asset, be it fungible or non-fungible, with regulatory obligations commensurate to the risks posed by these assets.

Response Q6: Do you see these policy objectives as appropriate?

Response Q7: Are there policy objectives that should be expanded on, or others that should be included?

The policy objectives are appropriate, however we would add one further objective.

There should be a balance between regulatory certainty, consumer protection, and innovation. The current objectives fail to recognise that a solid framework for crypto-assets should also support innovation. As such we believe that including as a policy objective that of 'supporting innovation and allowing regulated firms to mitigate risks while embracing the technological benefits and properties of blockchain technology' would be vital.

Response Q8: Do you agree with the proposed scope detailed above?

We agree with the proposed scope and in particular the proposed approach which aims to avoid regulatory duplication and having firms require multiple licences and be subject to multiple regulatory regimes.

Response Q9: Should CASSPrs that engage with any crypto-assets be required to be licenced, or should the requirement be specific to subsets of crypto-assets? For example, how should the regime treat non-fungible token (NFT) platforms?

Given the proposed definition of a crypto-asset, there could be an argument that an NFT which, for example, only provides artistic value, is not a 'digital representation of value or contractual rights' and as such would not be in scope of the regime. However, NFTs are often used for speculative purposes, and a number of NFT trading platforms transact in NFTs of significant value. Where NFTs are used for investment purposes, and are at risk of being abused for money laundering and terrorist financing purposes, we believe that the appropriate customer protection and AML/CTF standards should apply.

As such, we believe CASSPrs which offer the ability to trade NFTs, over a certain monetary threshold, should be subject to the regime. The exact threshold should be examined and put to industry consultation.

Response Q10: How do we best minimise regulatory duplication and ensure that as far as possible CASSPrs are not simultaneously subject to other regulatory regimes (e.g. in financial services)?

Where a crypto-asset also has some characteristics of financial products but it is not abundantly clear that it falls under the existing financial product regulations, these should ideally be regulated under the bespoke CASPPr regime, provided that the regulatory risks with regards the financial products are appropriately mitigated. Given that both regimes will be overseen by ASIC, we believe that this approach would be suitable and avoid unnecessary regulatory duplication.

Should a provider already be regulated under the AFS regime, it should not be required to obtain a separate CASSPr licence if it is also providing crypto services, provided that they comply with the requirements in the CASSPr regime for the crypto-asset services they provide. We have provided the suggestion of a "fast track" process to avoid regulatory duplication.

We further suggest that clear guidance with regards scope of financial products and crypto-assets is issued and implemented.

3.1 Regulatory Obligations

As underlying principles, the regulatory obligations proposed are reasonable, however the devil will always be in the detail and we would encourage a collaborative approach in developing any secondary regulation or guidance.

We would also urge for an appropriate transition period so that existing operators are able to comply with these enhanced standards. There should be a safe harbour mechanism in place for existing businesses, allowing them time and flexibility in order to comply with the CASSPr regime.

The prohibition on hawking or pressure to sell specific crypto-assets is reasonable, although we believe a CASSPr should have the ability to be licensed to offer certain crypto advisory services provided the risks to consumers are mitigated.

Response Q11: Are the proposed obligations appropriate? Are there any others that ought to apply?

The obligations are appropriate, however the industry would need to see further detailed legislation and the supporting guidance. We would encourage Government to develop this in collaboration with the industry.

We would also suggest that obligation 1 is broken down further, in order to prominently cover two distinct obligations, the first that the services covered by the licence are provided efficiently, honestly and fairly, and the second that any market for crypto-assets is operated in a fair, transparent and orderly manner.

We believe that in particular digital currency exchanges should have policies and procedures concerning the practices and technology used to perform market surveillance of the platform's trading environments in order to curb market manipulation and promote orderly markets. This is standard policy for traditional supervised markets and should be carried over to supervised crypto markets as well.

Response Q12: Should there be a ban on CASSPrs airdropping crypto-assets through the services they provide?

We do not believe that there should be a ban on airdrops provided they are delivered in a legally compliant way.

Response Q13: Should there be a ban on not providing advice which takes into account a person's personal circumstances in respect of crypto-assets available on a licensee's platform or service? That is, should the CASSPrs be prohibited from influencing a person in a manner which would constitute the provision of personal advice if it were in respect of a financial product (instead of a crypto-asset)?

We believe that regulated providers should have the ability to offer 'advice' regarding crypto-assets, providing the appropriate consumer protections are put in place and the CASSPr regime includes specific requirements on 'crypto advisors'.

Response Q14: If you are a CASSPr, what do you estimate the cost of implementing this proposal to be?

We would find it extremely difficult to quantify costs of implementation given that the detailed requirements of the regime are not yet formulated. However, given the proposed regulatory obligations, the cost of compliance is likely to be significant. Given this is the case, we would encourage exploring the ability for smaller providers to be approved to undertake CASSPr activities through a regulated third party and existing authorised CASSPr (similar to how the current Authorised Representative regime works for AFS holders).

Response Q15: Do you support bringing all crypto assets into the financial product regulatory regime? What benefits or drawbacks would this option present compared to other options in this paper?

Response Q17: Do you support this approach instead of the proposed licensing regime? If you do support a voluntary code of conduct, should they be enforceable by an external dispute resolution body? Are the principles outlined in the codes above appropriate for adoption in Australia?

We would not support bringing all crypto-assets into the financial product regulatory regime and would not consider this approach appropriate for the reasons outlined by the industry in their submission to the Senate Committee, including those industry views outlined in the Blockchain Australia submission.[2] Likewise, we do not believe that a self-regulatory regime will achieve the desired outcomes of the Senate Committee.

4. Digital asset custody

Response Q19: Are there any proposed obligations that are not appropriate in relation to the custody of crypto assets?

Response Q20: Are there any additional obligations that need to be imposed in relation to the custody of crypto assets that are not identified above?

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2 https://www.aph.gov.au/DocumentStore.ashx?id=a2505544-fbce-4e68-9d7f-5a9596716af4&subId=711423

Response Q22: Are the principles detailed above sufficient to appropriately safekeep client crypto assets?

We believe that sound custody arrangements are essential in order to bring appropriate protections to consumers. Many CASPPrs custody customer funds, as opposed to the traditional financial services world where firms rely on 3rd party custodians.

We welcome the principles-based proposed obligations as outlined in the consultation paper, these will ensure that operators implement robust controls both for online (hot) and offline (cold) storage of crypto-assets. A principles based approach to custody will also allow firms to adapt and upgrade their custody policies, processes and controls in line with advances in industry standards.

We suggest also requiring firms to be subject to independent security audits.

Response Q21: There are no specific domestic location requirements for custodians. Do you think this is something that needs to be mandated? If so, what would this requirement consist of?

Response Q23: Should further standards be prescribed? If so, please provide details.

We are strongly opposed to a move towards onshore custody or the mandating of a third-party custodian. While it may be considered more effective for some providers to outsource custody, larger more sophisticated groups such as FTX have invested significant sums in developing robust security practices which achieve the necessary levels of security while keeping custody of assets 'in-house'. In fact, engaging with a third party provider could arguably provide an additional (and at times easier) attack vector for nefarious actors and place customer funds at a higher level of risk.

With regards to mandating onshore custody, we believe that geographic location of private keys and signing processes is important. Certain circumstances may warrant safeguarding keys in one geographical location, however, the industry standard is ensuring that keys are held and signed in different geographic locations as opposed to a single one. We believe that limiting custody to a single geography could lead to additional risks, rather than mitigating them. Geographical risks and a geographical risk assessment should be expected from entities when adopting industry best practice with respect to custody and security over private keys. Allowing flexibility in achieving the desired outcomes in an industry where standards are constantly changing will be essential in order to establish a regime which can be future proof.

We thank Treasury for the opportunity to provide this submission. Should you have any questions, please contact [redacted] at [redacted].